International Securities

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The following report covers the past year's principle developments relating to the issuance and sale of securities cross borders in the United States and Canada. This report does not include major developments in securities law that affect the United States alone, or other countries other than the United States and Canada.

I. Development in the United States

A. Alternative Trading Systems and the Future of Stock Exchanges

In 1999, a major impact of the Internet was on traditional stock and option exchanges. From the inception of cybersecurities, the Internet has been used by customers to place orders with online brokers, but not as the method of execution between brokers or between a broker and an institution. Instead, online brokerage firms have executed through either private networks, such as NASDAQ, extranet-based trading facilities like Instinet, stock exchanges, or other means. The markets are moving inexorably to the completion of all brokerage on the Internet.[1] Further, it is likely that in the end there will be "straight-through-processing," in which all aspects of the securities transaction and all kinds of products will be marketed, sold, and cleared electronically by Instinet-type firms.[2] As one observer put it: "Today, technology is shaking the bedrock of our industry's value proposition, threatening to revolutionize the fundamental way we manage information, interact with

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1. *See* Robert Mika, *Global STP Committee: Survival Could Be the Real Issue*, Sec. Inc. News, July 27, 1998, at 2. Electronic trading entering 1999 was used in 25% of stock transactions by individual investors, much of which is executed on electronic networks like The Island ECN, owned by Datek, and Archipelago. Island reported 2.5 billion shares traded in 1998, while Archipelago reported 650 million. The OptiMark trading system, which allows institutions to trade directly and anonymously with one another, was rolled out in January 1999.

2. *See id.*

clients and execute trades. All of this is being brought on by the concept of ubiquitous connectivity—ability to connect with anyone, anywhere, at any time."[3]

Of the new technology, electronic communications networks (ECNs) have perhaps worked the most dramatic change. Sources and users of liquidity are now able to find each other much faster and more broadly than ever before. The ability for investors to bypass their broker-dealers and execute transactions directly between themselves was pioneered electronically by Instinet. By mid-1999, eight other ECNs had entered the field, and the nine ECNs accounted for more than thirty percent of Nasdaq-traded securities. Of this volume, direct execution by retail and institutional investors made up more than half.[4] The growing competition from ECNs has raised such concerns over the very existence of the auction markets conducted on exchange floors that the chairman of the London International Financial Futures and Options Exchange (LIFFOE) questioned "whether you'll even need exchanges in the next century."[5] The LIFFOE in fact decided in September 1998 to close its trading floors for bonds, index futures, currency contracts, and equity options.[6]

In April 1999, new SEC rules for ECNs and other screen-based alternative trading systems (ATSs) took effect, which included a controversial provision requiring larger-volume ATSs, such as Instinet, to publicly display their institutional orders.[7] In adopting the rule, the SEC noted that volume on ATSs had significantly increased in recent years, and now accounted for about twenty percent of transactions in Nasdaq securities and four percent of transactions in listed securities.[8] With ATSs being regulated as traditional broker-dealers, the SEC saw regulatory gaps result, raising substantial concerns where an ATS has significant volume.

The new rules alter the scheme applicable to exchanges in three significant ways. First, a new regulatory framework allows an ATS to choose between registering as an exchange and registering as a broker-dealer. Second, registered exchanges can now operate as for-profit businesses. Finally, under the new scheme, most ATSs (which are relatively small), will choose to register as broker-dealers and have regulatory requirements substantially similar to what they currently undertake. As registered broker-dealers, these ATSs will continue to be covered by the oversight of one of the self-regulatory organizations. Provided an ATS has limited volume, it will only have to file a notice with the Commission describing the way it operates, maintain an audit trail, and file quarterly reports.

An ATS with substantial trading volume, and therefore a potentially significant impact on the market (e.g., Instinet), that is registered as a broker-dealer must link with a registered exchange or the NASD and publicly display their best priced orders (including institutional orders) for those exchange-listed and Nasdaq securities in which they have five percent or more of the trading volume.[9] ATSs must also allow members of registered exchanges and the NASD to execute against those publicly displayed orders. Only those orders that participants in an ATS choose to display to more than one other participant must be publicly

3. Larry Tabb, *Seismic Shift: Ubiquitous Connectivity*, SEC. INC. NEWS, June 14, 1999, at 28.

4. *See id.* at 30.

5. *Id.* at C-8.

6. *See* Michael Dabaie, *Fate of Liffe's Trading Floor To Be Decided This Year*, SEC. INC. NEWS, Oct. 5, 1998, at 5.

7. *See* Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 34-40760, 68 S.E.C. Docket 2045 (Dec. 8, 1998), *available in* 1998 WL 849548.

8. *Id.*

9. *See id.*

displayed. Accordingly, the portion of orders hidden from view through "reserve size" features in ATSs do not need to be publicly displayed.

An ATS with twenty percent or more of trading volume also must ensure that its automated systems meet certain capacity, integrity, and security standards. This is intended to prevent the system outages—and resulting disruption to the market—experienced by some ATSs during periods of heavy trading volume. Such an ATS must refrain from unfairly denying investors access to its system. This requirement is to prohibit unfair discrimination among investors and broker-dealers seeking access. The system is free to establish fair and objective criteria, such as creditworthiness, to differentiate among potential participants.[10]

The SEC at the same time addressed the disparity under which, unlike ATSs, registered exchanges and the NASD are required to submit all of their rule changes for Commission review. To avoid this impediment to the exchanges' ability to compete effectively by slowing the development of innovative trading systems and the introduction of new products, the first rule temporarily exempts registered exchanges and the NASD from the rule filing requirements so that they may operate pilot trading systems for up to two years. During this two-year period, the pilot trading system is subject to strict volume limitations. The operator of the pilot trading system will also have to ensure that the trading activity on that system is being adequately surveyed. This rule is intended to enhance the registered exchanges' and the NASD's ability to compete with ATSs registered as broker-dealers and to bring innovative trading systems to market.

The second rule creates a streamlined procedure for the registered securities exchanges and the NASD to quickly begin trading new derivative securities products. Under the new rule, if a registered exchange or the NASD has existing trading rules, surveillance procedures, and listing standards that apply to the broad product class covering a new derivative securities product, the new product can be listed or traded without Commission approval.[11] Finally, the SEC stated that it would work to accommodate, within the existing requirements for exchange registration, exchanges wishing to operate under a proprietary structure. This allows ATSs that are proprietary to register as exchanges and for currently registered exchanges to convert to a for-profit structure.[12]

B. The Charles Schwab No-Action Letter: Opening the Internet Roadshow

Nineteen ninety-nine marked a further advance in opening up "roadshows" to more participants. The typical roadshow involves presentations made by the issuer and its underwriters to large investors, institutions, and analysts prior to underwritten public offerings. In the presentations, the issuer's management and the underwriters explain the issuer's business and industry as well as the offerings and respond to questions. The Internet raised several new kinds of roadshow issues, because the Securities Act prohibits the transmission of any "prospectus" relating to a security being publicly offered unless it is the same preliminary prospectus on file with the SEC.[13] "Prospectus" is broadly defined in the Securities Act to include any "prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale or confirms the sale of

10. *See id.*

11. *Id.*

12. *See* Regulation of Exchanges and Alternative Trading Systems, Exchange Act Release No. 34-39884, 67 S.E.C. Docket 2339 (Apr. 17, 1998), *available in* 1998 WL 187835.

13. Section 5(b) of the Securities Act prohibits use of any "prospectus" that does not meet the requirements of section 10 of the Securities Act.

any security."[14] The question arose whether an electronic "roadshow" is like a written, radio or television communication and hence an impermissible "prospectus" under the Securities Act.

In 1997, the SEC first concurred that a virtual roadshow by Internet would not constitute a Securities Act "prospectus" where, among other things, a web site for roadshows regarding public offerings would be established, with a posted index of those available for viewing by qualified investors and by the underwriting investment banks. The roadshows would be indexed by offering company, underwriter, and industry classification.[15] To view an online roadshow, a qualified investor would be required to contact an institutional salesman or the syndicate department at one of the underwriters and access codes would be required. The qualified investors would be typical of those customarily invited to attend live roadshows (e.g., registered broker-dealers and investment advisers).[16]

The 1999 expansion of the population eligible to attend electronic roadshows came in a no-action letter that allowed Charles Schwab & Co., Inc. to make its electronic roadshow available to all of its clients whom it allows to participate in initial public offerings (IPOs).[17] Substantially all of these are individual investors who buy at retail. Schwab's requesting letter stated that Schwab would provide password-protected access to its Gold Signature Services accounts, which represent less than twenty percent of its 6.3 million customers, as well as to its not more than 10,000 independent investment advisers clients. Schwab stressed that, to qualify for a Gold level account, a client must have a trading history of at least twenty-four trades per year or assets of at least $500,000 equity in household investment positions.

Schwab argued in its requesting letter that advances in information technology should empower investors by making appropriate information accessible as widely, as quickly, and as efficiently as possible. It contended that "road show information should not be reserved for a select few, but should be more broadly available to investors who are considering participation in a given offering, regardless of their individual size or market power."[18] While it did not propose to make roadshows generally available, it said "that it is not appropriate to make artificial distinctions that keep relevant information hidden from retail investors who might participate in the offering, while it is made available to all others who might buy in the offering."[19]

Although the foregoing method would permit access to potentially hundreds of thousands of investors, the SEC in the Schwab no-action letters required password-limited access. There have been suggestions that a more liberal approach may be down the road in 2000, but the ultimate outcome is uncertain.

14. 15 U.S.C. § 77b(11) (1999).

15. *See* Net Roadshow, Inc., SEC No-Action Letter (Sept. 8, 1997), *available in* 1997 WL 555935. The letter applied the doctrine of a prior no-action position that found no "prospectus" in a closed-circuit video transmission. *See* Private Financial Network, SEC No-Action Letter (Mar. 12, 1997), *available in* 1997 WL 107175.

16. In late 1997, Bloomberg, the online investment news service, gained SEC permission for its Internet roadshow presentations. The Bloomberg presentations also limit access to persons who have been authorized by the underwriters to view the roadshow. The difference in Bloomberg's roadshow from that of Net Roadshow is its *simultaneous* broadcast.

17. Charles Schwab & Co, Inc., SEC No-Action Letter (Nov. 15, 1999), *available in* 1999 WL 1038050.

18. *Id.*

19. *Id.*

C. The Wit Capital No-Action Letter: Pre-effective Reconfirmation

In 1999, Wit Capital Corp. (Wit) received a significant no-action letter from the SEC confirming the propriety of certain procedures it used in the public offering of securities over the Internet.[20] Wit requested confirmation that its customers could, in a window period beginning up to forty-eight hours prior to expected effectiveness of a registration statement, receive reconfirmation from a customer of that customer's conditional offer for shares in the offering. Wit also requested confirmation that it could require a new customer to fund its account prior to effectiveness, in accordance with Wit's generally applied minimum for account opening, and not be in violation of section 5(a) of the Securities Act by having "sold" the securities prior to the effectiveness of the registration statement.

In its requesting letter, Wit described its modified first come, first served system for allocating shares among customers in public offerings. Thus, if a customer places a conditional offer shortly after the preliminary prospectus becomes available, several weeks may elapse before the offering is actually priced and sold. Wit evolved a procedure that employs a series of e-mails to its customers to explain the mechanics of the offering and to reconfirm their orders.

In seeking the SEC's concurrence that the materials sent by Wit to the customers relating to account opening and the like did not constitute illegal prospectuses in violation of section 5(b)(1) of the Securities Act, Wit stressed that the web site on which the communications reside was a sort of "cul de sac" that limited the navigational tools within the site. There are no hyperlinks out of the cul de sac to the remainder of the web site. Thus, to navigate outside the cul de sac, the viewer had to use the navigational tools of the browser, for example, clicking the back button, typing in a new URL, or choosing a bookmark. Inside the cul de sac, the only selling documents that would be found are Rule 134 compliance, permissible free writing, or the preliminary prospectus. The SEC agreed that Wit's communications related to operating procedures and did not provide information regarding either the issuer or the particular offering, hence did not violate section 5(a).

The SEC agreed that a customer can be firmly committed to buying in a public offering prior to the effective date of a registration statement, and in expanding the time window in which customers that interact with their broker-dealer through the Internet, can legally "reconfirm" their offer to purchase.

D. International Disclosure Standards and Amendments to SEC Form 20-F

In September 1999, the SEC adopted changes to its nonfinancial statement disclosure requirements for foreign private issuers, to conform those requirements more closely to the International Disclosure Standards endorsed by the International Organization of Securities Commissioners (IOSCO) in September 1998.[21] The purpose of the changes is to harmonize disclosure requirements on fundamental topics among the securities regulations of various jurisdictions.

The SEC, which long has supported the concept of a harmonized international disclosure system, has been working with other members of IOSCO to develop a set of international

20. Wit Capital Corp., SEC No-Action Letter (July 14, 1999), *available in* 1999 WL 498545.

21. International Disclosure Standards, Exchange Act Release No. 33-7745, 70 S.E.C. Docket 1474 (Sept. 28, 1999), *available in* 1999 WL 770251.

standards for disclosures (other than in financial statements) that could be used in cross-border offerings and listings. The International Disclosure Standards developed by IOSCO reflect a consensus among securities regulators in the major capital markets as to the types of disclosures that should be required for cross-border offerings and listings. The International Disclosure Standards cover fundamental disclosure topics, such as the description of the issuer's business and results of operation.

The SEC amended Form 20-F, the basic 1934 Act registration statement and annual report form used by foreign issuers, to incorporate the International Disclosure Standards. At the same time, the SEC revised the 1933 Act registration forms designated for use by foreign private issuers, and related rules and forms, to reflect the changes in Form 20-F. None of the amendments alter the financial statement reconciliation requirements for foreign issuers. The SEC will continue to require disclosure on topics not covered by the International Disclosure Standards, such as disclosures relating to market risk and specialized industries such as banks. Unlike the IOSCO International Disclosure Standards, which were intended to apply only to offerings and listings of common equity securities and only to listings and transactions for cash, the amendments to Form 20-F apply to all types of offerings and listings and to annual reports. The SEC also revised the definition of "foreign private issuer," which determines an issuer's eligibility to use certain Commission forms and benefit from certain accommodations under Commission rules, and to clarify how issuers should calculate their U.S. ownership for purposes of the definition.

E. Giving Away Free Stock on the Internet

One of the unique by-products of the Internet is the giving away of free securities to online viewers. One of the first of the breed was Travelzoo.com. This online travel service, located in the Bahamas, began giving away its stock in the summer of 1998. Travelzoo.com limited visitors to its site to no more than three free shares each, which are held electronically in the Bahamas.[22] Travelzoo.com claimed that it will benefit from giving away free stock because it will attract so many "hits," or visitors, that advertisers and others will find its site to be an attractive venue. Travelzoo.com was followed by other free stock programs including E-Compare. In January 1999, the SEC in a no-action letter took the rather strained position that viewers, merely by clicking on to the issuer's web site, were passing "value," and hence consideration, to the issuer; accordingly, the staff said such giveaways had to be registered under the Securities Act.[23] A greater problem for "giveaway" issuers is how to satisfy the corporate law in those states that require shares to be issued for "consideration." The shares might be illegally issued in such jurisdictions (viz: Delaware) and the directors exposed to shareholder action.

In July 1999, the SEC filed four separate administrative consent judgments involving purportedly free stock on the Internet. Each of the factual situations went well beyond a simple online offering of stock. However, the SEC used each proceeding to articulate a

22. *See* Dan Frost, *Internet Firm Giving Away Its Stock*, S.F. Chron., July 29, 1998, at B-1.

23. *See* Vanderkam & Sanders, SEC No-Action Letter (Jan. 27, 1999), *available in* 1999 WL 38281; Simplystocks.com, SEC No-Action Letter (Feb. 4, 1999), *available in* 1999 WL 51836. A different situation was presented in American Brewing Co., SEC No-Action Letter (Jan. 27, 1999), *available in* 1999 WL 38280, because the "free" shares actually required purchase of the issuer's product.

new doctrine on "gifts" and to suggest that any stock giveaway will be deemed a "sale" under the Securities Act.[24]

Despite the fact that all four proceedings involved fact patterns that violated long-established doctrines under the Securities Act, the SEC introduced a new interpretation of when a "gift" becomes "sale," stating that: "A gift of stock is a 'sale' within the meaning of the Securities Act when the purpose of the 'gift' is to advance the donor's economic objectives rather than to make a gift for simple reasons of generosity."[25]

The ambiguous phrase, "simple reasons of generosity," had not been previously used in any reported securities case or SEC release. The phrase leaves it unclear whether a donor's "economic objectives" can play no role or only a subordinate role in the gift of stock.

The SEC's position is somewhat incongruous in view of its staff's processing of the registration statement filed by Younetwork Corp. in 1999. This issuer proposed to distribute the first 250,000 of one million shares of $.0001 par value Class A common stock "at no cost" to each of the first 250,000 members of its consumer network.[26] Members of the network would be eligible for rates on products and services purchased through the issuer's site. Another 750,000 shares would be distributed to members based on the number of other members that they directly or indirectly recruited. For purposes of computing the filing fees, the SEC put a zero value on the free shares, which is directly at odds with the theory of its no-action position. Even more inconsistent was the SEC's processing of the registration of DoctorSurf.com, Inc., which registered twenty-five million shares of common stock that it proposed to give away in 100 share lots to the first 350,000 doctors who became members of its web site and provided detailed biographical information.[27] The aim of the issuer was to provide a "one stop" web portal for all of a doctor's informational and shopping needs.[28] In any event, a stock giveaway must take account of the SEC's present position and can be accomplished by use of one of the recognized exemptions, such as SEC Rule 504, unless the "free" shares are registered.[29]

F. The "Dutch Auction" IPO Process

Nineteen ninety-nine saw the introduction of the "dutch auction" system of online IPOs, developed by a new venture of William Hambrecht, co-founder of Hambrecht & Quist. The system allows institutions, professionals, and individual investors to enter bids at a fixed price on a confidential basis on the Internet for a certain number of shares being publicly offered. The total of all the best bids which, in the aggregate, cover the minimum number of shares being offered, win the right to purchase such shares pro rata at the lowest of the best bids. For example, if one million shares are offered and the best of the total bids equaling one million shares range from fifteen to twenty, all of the one million shares would be sold at fifteen to those who had bid fifteen or higher. (All bids under fifteen would be eliminated.) The Hambrecht dutch auction is not yet being conducted as a direct public offering (DPO) with the firm simply acting as agent, but as a new species of firm underwriting. The SEC has been requiring the firm to treat the bids as indications of interest

24. *See* Denis Rice, *Free Stock on the Internet Is Not A Menace*, 13 Insights 9 (Oct. 1999), 8.

25. *Id.*

26. *See* SEC File No. 333-71949. The registration became effective on July 13, 1999.

27. *See* SEC File No. 333-80475.

28. *See* <http://www.doctorsurf.com>.

29. *See* Rice, *supra* note 24, at 12.

and to take title to the registered securities before promptly confirming their resale to the successful auction bidders. Accordingly, the firm is "at risk" in much the same way as the traditional underwriter. The dutch auction has a distinct advantage over DPOs, in that the underwriter "works" the institutions and its existing base of clients and conducts road-shows, all for the purpose of stimulating interest in the offering.

G. Venture Capital on the Internet

In the spring of 1998, a venture capital site for smaller investors leapt onto the Internet. Named after the Silicon Valley dream in which successful companies start in a garage, Garage.com screens potential venture investors into membership, which allows them to invest seed capital in new companies whose business plans have been vetted by its staff.[30] Since the summer of 1999, Garage.com has generated a steady flow of deals, having secured its broker-dealer registration.

In December 1999, meVC Draper Fisher Jurvetson Fund I, Inc., a closed-end investment company that elected to be regulated as a business development company under the 1940 Act, filed with the SEC a registration statement relating to a proposed IPO of common stock. The object is to create a publicly owned venture capital fund focusing on long-term capital appreciation from venture investments in information technology companies, primarily in the Internet, e-commerce, telecommunications, networking, software, and intranet infrastructure industries. The registration became effective on March 24, 2000. This represents a further example of the march of venture capital toward smaller investors.

H. New Rules to Facilitate Cross-Border Transactions

The year 1999 also saw the adoption by the SEC of new rules to facilitate participation by U.S. holders of securities of foreign corporations in cross-border tender offers, business combinations, and rights offerings.[31] The new rules allow tender offers for the securities of non-U.S. issuers to generally be made on the basis of the applicable regulations of the target issuer's home jurisdiction, when U.S. holders hold ten percent or less of the class of securities sought (the "Tier I" exemption). They also make limited exemptions from the U.S. tender offer requirements available to allow tender offers for securities of non-U.S. issuers when U.S. holders hold forty percent or less of the class of securities sought, without the need to obtain case-by-case relief to harmonize conflicting rules (the "Tier II" exemption). In addition, rights offerings by non-U.S. issuers generally can be made on the basis of applicable regulations of the target issuer's home jurisdiction when U.S. holders hold ten percent or less of the class of securities sought (the "Rule 801" exemption).

Exchange offers for the securities of non-U.S. issuers generally can be made on the basis of applicable regulations of the target issuer's home jurisdiction when U.S. holders hold ten percent or less of the class of securities sought (the "Rule 801" exemption). Under certain circumstances, tender offers for the securities of non-U.S. issues will be deemed to be outside the tender offer when U.S. holders hold ten percent or less of the class of securities sought.

30. *See* Lisa Bransten, *Entrepreneurs May Find Heaven at Garage.com;* Wall St. J., May 14, 1998, at A-6.

31. On October 26, 1999, the SEC adopted Release No. 33-7759, containing various exemptive rules. The rules became effective on January 24, 2000.

Qualifying for the new exemptions will, in certain cases, require the offeror to make filings with or furnish information to the SEC and to observe certain U.S. procedural requirements. However, these procedural requirements are significantly less extensive than the SEC requirements previously applicable to these transactions.

The general antifraud and civil liability provisions of the U.S. federal securities laws, which relate principally to material misstatements and omissions in connection with the sale of securities, will continue to apply to any tender or exchange offer or rights offering made to U.S. security holders. In view of the requirement in the new rules that written information be disseminated to U.S. security holders or published in the United States if it is used in the home jurisdiction, tender offer materials and offering documents in transactions that are exempt under the new rules will need to be prepared with the potential for liability under U.S. law in mind.

II. Developments in Canada

A. Jurisdiction

Across the border in Canada, there were significant developments in 1999 on both the judicial and the regulatory fronts. *Braintech, Inc. v. Kostiuk* was a case that did not directly involve securities but whose holding on jurisdiction could have impacts on cross-border trading.[32] Braintech, a British Columbia software company, had research and development sites and approximately ten percent of its shareholders in Texas. It sued a resident of British Columbia over an alleged posting of defamatory messages by the defendant concerning Braintech on a U.S. web site called "The Silicon Investor." Braintech brought the action in Texas, alleging defamation and business disparagement in Texas, and made substituted service on the Texas Secretary of State. The Secretary of State in turn forwarded the proceedings to the out-of-state defendant in British Columbia, who failed to appear. The Texas court took jurisdiction on the ground the tort was committed in Texas by means of an Internet publication, granted default judgment in favor of Braintech, and awarded damages.

When Braintech sued to enforce the action in the trial court in British Columbia, it obtained judgment. However, the Court of Appeal of British Columbia subsequently reversed. Re-examining the mode by which defamation was published, it concluded that the state of Texas had been wrong in finding the tort had been committed in the state of Texas, because there was no proof that anyone actually read the Internet message. The Court of Appeal also concluded that it would be necessary for Braintech to establish that the defendant had a commercial purpose in transmitting the message into the state of Texas. It further concluded since there were insufficient minimum contacts between the defendant and the state of Texas, the Texas court was not justified in taking jurisdiction. As a result, comity did not require the British Columbia courts to enforce the judgment.[33]

Although the case involved defamation, it can have implications in securities as well. The decision suggests that mere access to U.S. Internet investment advisory sites by Canadian investors, even to acquire Canadian stocks, may not provide a sufficient nexus to regulate the transaction from the point of view of the extraterritorial application of Canadian securities legislation.

32. Braintech, Inc. v. Kostiuk, B.C.J. No. 622 (1999) (Can.).
33. *Id.*

B. Online Offerings

January 1999 saw the first online direct initial public offering made in Canada without the use of an underwriter. The issuer was e-minerals Exploration Corp. (eEC).[34] As with U.S. direct public offerings, the company had to deal with issues such as jurisdiction, security, "know your client," and prospectus delivery. eEC overcame the jurisdictional issue by using a disclaimer that indicated the offering was *only* available to Ontario residents, thereby effectively excluding residents from all other jurisdictions. This is similar to a procedure that was adopted in the United States several years ago under a policy of the North American Securities Administrators Association (NASAA). To meet "know your client" requirements, the online subscription forms required each investor to answer a series of questions concerning the investor's risk tolerance, volatility, investment objectives, knowledge, and investment horizon. That information was compared with previously determined standards to evaluate each investor, and in some cases an investor was rejected from the offering.

eEC also provided for credit cards to be used as a vehicle for receiving payment from investors, in addition to checks and money orders. In the United States, the SEC previously used its exemptive authority to allow credit cards in public offerings.[35] While the Canadian scheme does not proscribe credit card payments, the issuer agreed to insert in the prospectus certain warning language similar to that which had been required by the SEC:

> The company does not recommend short-term borrowing to fund speculative investments such as the Common Shares of e-minerals. Investors should not carry a balance on their credit cards or obtain new credit cards to purchase Common Shares of e-minerals, as the cost of borrowing would reduce the potential return from investment. If an investor were to carry the full purchase amount of an investment in Common Shares of e-minerals, on his or her credit card, the cumulative finance charges could conceivably exceed any return from the investment.[36]

Because there was no broker-dealer involved, eEC was also required by Canadian law to register as a "securities issuer."

34. *See* <http://www.e-minerals.com>.

35. *See* Technology Funding Securities Corporation, SEC No-Action Letter (May 20, 1998), *available in* 1998 WL 293330.

36. *See* eEC Prospectus, at 19. Unlike the United States, direct public offerings in Canada made without another registrant or dealer involved, require the issuer to register as a dealer. Accordingly, eEC registered as a "security issuer" under Ontario securities laws.